HEA 1001 - 2002 special session

The 2002 special session was, by all accounts, an unusual and historic affair. There were rumors, uncommon alliances, and political maneuvers. But in the end, pressure from key constituent groups, the genuine desire of legislators to improve Indiana, and some last-minute deal-brokering salvaged the session and a landmark piece of legislation was passed. HEA 1001-ss restructured the tax code, provided significant property tax relief, and raised revenue for the state's ailing budget.[1]

Unlike the regular session where the debate began on separate tax restructuring and deficit reduction bills authored by the O'Bannon administration, HB 1001-ss was introduced by Representative Bauer and was similar to the House passed version of HB 1004. It was not the only plan being promoted, as Republican Senators Borst and Kenley had unveiled proposals during the few weeks between sessions. On top of these legislative proposals, the Alliance for Indiana's Future (the influential coalition of labor, education, and business) also produced a comprehensive plan.

The House Ways & Means Committee held a series of hearings on tax restructuring and the state's fiscal crisis. Negotiations failed to produce the hoped-for bipartisan solution, but the bill managed to pass out of committee by a narrow vote with some Republican support. A great deal of compromise occurred before the second reading vote, and the individual income tax was removed. The bill narrowly passed the House 51-47. Representative Bauer announced Senators R. Meeks and Vi Simpson as the sponsors, but Meeks would be replaced by Senator Borst in short order.

Senator Borst held two hearings on HB 1001-ss in the Senate Finance Committee before he presented a comprehensive amendment that radically altered the bill. The new version revived the idea of an income tax increase (3.4% to 3.9%), which was widely thought to be a non-starter with House Republicans and Democrats alike. It also removed 100% of the school general fund from the property tax levy. But the major difference from the House-passed version was the lesser amount of new revenue for the deficit– approximately $230 M in FY 2003, $420 M in FY 2004, and $350 M in FY 2005.

Frustrated with not having been included in the crafting of such important legislation, four of the five Democrats on the Senate Finance Committee voted against the amendment. These legislators also criticized the comparatively low amount of new revenue for the budget. However, the votes of all Republican members and one Democrat were easily enough to move the measure to the floor. But despite unity in Senate Finance, many in the Republican caucus balked at the income tax increase and the supplemental tax on business pass-through entity income.

Senator Simpson worked with several members of the Republican caucus to develop another approach, and the viability of this plan appeared to serve as a catalyst. Senator Borst then re-worked his Senate Finance plan and produced a set of amendments for second reading. When adopted in succession, these amendments could have added dockside gambling while removing the income tax increase and the Business Supplemental Tax. Senators Simpson, Breaux, Howard, and other Democrats spoke against Senator Borst's approach, averring that it did not represent enough of a compromise and did not raise enough revenue for the deficit. The first amendment failed, leaving the income tax increase intact and ensuring that this plan was

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[1] Pressure on this latter front had intensified since the regular session after the State Budget Agency informed legislators that monthly revenue reports for April and May were more than $200 M below forecasted levels.

doomed. When Sen. Simpson's comprehensive amendment containing the alternative proposal was rejected by the majority, it seemed clear that the session was finished.

Senator Borst blamed the gaming lobby for "choking" the bill, and after leaving the floor accompanied Senator Garton to the Governor's office. Despite all previous indications, the word spread that a compromise was beginning to be forged and that a third reading amendment would be permitted on Friday, June 21st. The strategy was now to obtain a concurrence in the House with the Senate-passed version, as a conference committee seemed unlikely to succeed with so little time left.[2]

With Governor O'Bannon now involved and helping to facilitate a compromise, Senators Borst and Garton made concessions to Senate Democrats on the Earned Income Tax Credit and the Renter's Deduction (see attached summary chart). Further negotiations directly between leadership of the Senate caucuses yielded compromise on the gaming portion of the bill, although the House-passed French Lick and pull-tab gaming language was not reinstated. A solid majority of each caucus now supported the revised third-reading amendment, and the final vote tally was 33-15. (RC)

Early Saturday evening, the House convened and heard more than an hour's worth of passionate (and occasionally emotional) comments from members of both parties. Eventually, Representative Bauer closed the discussion, told legislators to vote their consciences, and offered a motion to concur with the version sent by the Senate. The motion failed 43-54 (RC 11ss), and most observers thought that the bill was dead before word spread that it was only the motion that had failed, and such a motion could be called again.

The caucuses huddled around leadership, and Speaker Gregg (who voted against the measure) negotiated with Representative Bosma over how to resolve the impasse. A few minutes later, the two leaders emerged from the wings and the motion was called again. Tense moments followed as a number of lights flickered from red to green and back again, but at 51-45 (RC 12ss) the machine was closed and it was done. Some Democrats said that they switched their votes based on a promise from the Governor to restore funding to CHOICE and several youth programs cut as part of the administration's Deficit Management Plan.

The final version of HEA 1001ss (PL 192) was not unlike what Lieutenant Governor Joe Kernan put forth on Oct. 18th, 2001 (introduced in January as HB 1003-'02). As can be seen in the attached chart, the bill significantly overhauled corporate taxation in Indiana and made sweeping changes in property taxation. The highlights are summarized below:

<u>Budget Relief</u>

While not technically dedicated for the budget crisis, the new spendable revenue from HEA 1001-ss essentially came from a $0.40 per pack increase in the $0.155 cigarette tax and a new graduated wagering tax for riverboats (based on the structure in Illinois). Along with increased riverboat taxes, the bill allowed dockside gaming to help Indiana's casinos compete with Illinois and boost state tax revenue. The bill was expected to raise about $600 M annually through FY 2005, which was significantly less than the $1 B figure sought by Representative Bauer in the House-passed version.

<u>Individual Taxes</u>

The Individual Income Tax increase was removed, leaving the 1% increase in the Sales

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[2] With statute limiting the special session to forty days, the deadline for ending the session was determined to be at midnight on Sunday night, June 23rd, 2002.

Tax to pay for most of the property tax relief. Democrats, concerned about the regressive nature of the Sales Tax, proposed expanding Indiana's Earned Income Tax Credit (EITC) by basing it on the federal EITC. This provision passed the House at 8% of the federal credit, but Senator Borst's initial proposal was 4%. Senate Democrats fought to raise this to the 6% level contained in HEA 1001-ss.

Property Taxes

Perhaps the central question of the 2002 regular and special sessions was whether or not the General Assembly would delay reassessment and take up restructuring in the longer 2003 session. But the final bill did not include a delay, but rather made significant changes to property taxation intended to mitigate the impact of reassessment. When all changes were taken into account, the legislation was predicted to provide a 13% decrease in the average Hoosier homeowner's 2003 property tax bill (no action was thought to have resulted in a 13% increase).

The Property Tax Replacement Credit was modified to apply to real property, mobile homes, and individual personal property only. This was mainly due to the reductions associated with personal property from reassessment and the return to the so-called "old rules" mandated by the bill. The Homestead Credit was doubled to 20%, but will now be applied after PTRC as opposed to simultaneously. The Department of Local Government Finance's proposed "shelter allowance" was voided and replaced with a $35,000 standard deduction from AV.

One of the most popular methods of reducing property taxes was removing the school general (or operating) fund from the local levy and provided 100% state funding. The House backed the suggestion of the education community to reduce not only the operating levy, but the transportation levy as well. The Senate-passed and enacted version replaced 60% of the general fund with state replaced funds but did not affect any other levies.

Business Taxes

The final bill achieved much of what was proposed in the Lieutenant Governor's November 2001 plan. The Corporate Gross Income and Supplement Net Income Taxes were eliminated and the Adjusted Gross Tax increased slightly. The Gross Income Tax remained only in the form of a new utility-only tax. Business property taxes were projected to fall due to reassessment and a return to the previous assessment manuals, and a mechanism for eliminating the inventory tax statewide by 2007 was enacted.

The R&D expense credit was doubled to 10% and the apportionment formula was removed to encourage more research within Indiana's borders. The LG had suggested 20% to make Indiana the national leader, but 10% was seen as a positive step. Senator Borst also added a venture capital tax credit that was previously developed with bi-partisan support in the Senate.

At more than 230 pages, HEA 1001-ss was still less bold than some versions of tax restructuring during the regular and special sessions. However, it was looked upon as a major legislative achievement, and Indiana received national recognition for tackling such complex issues in a short session during a fiscal crisis.